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CITIZENS
AGAINST
GOVERNMENT
WASTE

September 12, 2003

Chief
Regulations and Procedures Division
Alcohol and Tobacco Tax and Trade Bureau
P.O. Box 50221
Washington, DC 20091-0221

IN RE: Notice Number 4

Dear Sir,

Citizens Against Government Waste, the National Taxpayers Union and Taxpayers for Common Sense represent millions of taxpayers across the nation and are dedicated to exposing wasteful spending and burdensome regulations. The promulgation of unnecessary regulations, in particular, is one of the biggest threats to our nation's fragile economy. It is for this reason we respectfully submit our comments on the proposed regulations made by the Tax and Trade Bureau (TTB) in Notice Number 4 (Notice).

We believe the proposed rule change put forth by the TTB in the Notice to alter the way companies must manufacture flavored malt beverages (FMBs) is unjustified, unnecessary and based on misguided policy that represents a drastic change to the current regulatory scheme. Our five major points of contention are as follows.

1. There is no need for Notice Number 4. Since the late 1980s, the Bureau of Alcohol Tobacco and Firearms (BATF), now the Alcohol, Tobacco Tax and Trade Bureau (TTB), approved the current formulas and processes for FMB products, and many companies invested hundreds of millions of dollars in reliance on those approvals. In 1996, the agency ruled that it would place no limits on the amount of alcohol that flavors could contribute to a malt beverage. While that ruling suggested the possibility of future rulemaking, surely the deafening silence that followed would have persuaded any reasonable observer to conclude that the agency planned no changes. In short, the industry relied on Bureau guidance and now faces an unreasonable burden in complying with the proposed regulations. Please explain the rationale behind those actions.

2. The 0.5 percent standard that TTB proposes to impose relative to alcohol content source in flavored malt beverages is far more restrictive than the standards that TTB imposes on the source of alcohol in other beverages under its jurisdiction. E.g. 27 C.F.R. § 5.11 (defining distilled spirits to permit up to 50 percent of the alcohol to be derived from wine). We also encourage you to consider the Internal

Revenue Code's treatment of fortified wines (26 U.S.C § 5373) as an example supporting a less draconian standard than now proposed.

3. The Bureau regulates alcohol, and there is no question that alcohol is alcohol. As TTB knows, the alcohol-based flavorings used in the manufacture of FMBs are not distilled spirits because they are not fit for beverage purposes. There are no TTB regulations that could ever be used to determine that FMBs are considered distilled spirits, because the distilled spirits in flavors lose their identity as distilled spirits when blended with other ingredients to make a flavor. This whole rulemaking undermines this fact.

4. TTB's argument in support of .5 percent is fundamentally flawed because there is no evidence that Congress's inclusion of beer as a defined term in the Internal Revenue Code was intended for anything other than to create a threshold alcohol level that triggers taxation. There is no evidence that Congress had any notion of prescribing product formulations by enacting this taxation threshold. To the contrary, the following timeline demonstrates that the .5 percent threshold was

used to distinguish beer (and other products) from products containing de minimis levels of alcohol that were either not taxed or taxed at a lower rate.

• 1862 - Congress passes “An Act to provide Internal Revenue and decrease the public debt” that taxes beer. No definition of beer is included in the Act.

• 1913 - Congress passes the “Income Tax Law of 1913.” The law taxes beer (45 cents per gallon) and fruit juices (70 cents/gal. if containing less that 18 per centum of alcohol but if over 18 per centum then 70 cents/gal plus $2.07 per proof gallon on the alcohol contained)., There is no definition of beer in this law.

• 1917 - Congress passes “An Act to provide revenue to defray war expenses.” The new law levies a tax of $1.50 per barrel (of 31 gallons or less) on all “beer, lager beer, ale, porter, and other similar fermented liquor, containing one-half per centum or more of alcohol, brewed or manufactured” and also taxes unfermented grape juice, soft drinks, and fermented liquors containing less than one-half per centum of alcohol at a rate of I cent per gallon. The House report references this second category as “commonly known as near beer.”

• 1932 - Congress passes the Revenue Act of 1932. Section 615 — Tax on Soft Drinks, taxes all beverages derived in whole or in part from cereals but containing less that one-half of 1 per centum of alcohol by volume at the rate of 1¼ cents per gallon and all still drinks containing less than one-half of I per centum of alcohol by volume at 2 cents per gallon.

. 1934— Congress passes the Revenue Act of 1934 and repeals section 615 of the Revenue Act of 9932referred to above.

A review of the tax laws from 1862 forward demonstrates that Congress used the one-half of 1 per centum (or 0.5 percent) as a taxation threshold for numerous products. The threshold was also used to distinguish beer from “near beer.” However, the tax on near beers was repealed. Nevertheless, when the litany of revenue laws were later incorporated into the Internal Revenue Code (IRC), the language used to establish the taxing threshold for beer was kept and incorporated into the definition of beer.

What is clear from the historical review is that at no time did Congress consider formulation when it put a .5 percent malt threshold in the definition of beer.

5. If the TTB insists on going forward with requiring the reformulation of FMBs, we suggest that the agency consider evaluating what other federal agencies consider a reasonable standard for the use of flavorings. For example, if a juice product contains less than 100 percent juice, it may be called “juice” as long as the name employs a qualifying term such as “beverage,” “cocktail,” or “drink” to inform the consumer that the product contains less than 100 percent of the identified juice [21 C.F.R. § 102.33 (a)]. Moreover, if ajuice product is a blend of several juices, the product name may identify a juice that is not the predominant juice, provided that the product name specifically shows that the represented juice is used as a flavor, such as “raspberry-flavored apple and pear juice” [21 C.F.R. § 102.33 (b), (d)].

The Food and Drug Administration (FDA) regulations governing flavor labeling are also instructive. If a food is one that is commonly expected to contain a characterizing ingredient (e.g., strawberries in strawberry shortcake), and the food contains an amount of the ingredient sufficient to independently characterize the flavor of the food, any additional material flavor derived from the ingredient and added to the food need not also be indicated in identifying the food [21 C.F.R. § 101.22(i)(1)(i)]. By analogy, an amount of alcohol derived from fermentation sufficient to characterize an FMB (i.e., a majority, rather than .5 percent by volume) ought to be the standard.

Other FDA regulations, guidance, and interpretations that support a standard

higher than the .5 percent standard include:

• Preserves or jam vs. jelly: Preserves or jam must be made from concentrated whole fruit, whereas jelly is made from jelled fruit juice and other ingredients and need not contain whole fruit (21 C.F.R. §§ 150.140, 150.160).

• Malted milk vs. malted milk drink: FDA policy for “malted milk,” based on a definition established initially in 1936, provides that a “malted milk drink” must contain 5 percent malted milk (0.5 ounce malted milk in 10 fluid ounces of beverage) to bear the name (CPG 527.500). This 5 percent standard is well below the approximately 90 percent alcohol from the beer/malt beverage base requirement that TTB proposes to impose relative to alcohol content source in flavored malt beverages.

United States Department of Agriculture regulations also provide examples of labeling policy in support of the compromise proposal.

Sausage product identity based on majority: USDA policy on the labeling of sausage products containing both poultry and red meat products provides that the sausage is considered a “meat food product” if it contains more than 50 percent livestock ingredients, while it is considered a “poultry food product” if it is more than 50 percent poultry. The secondary ingredient must qualify the product name, e.g., “Turkey Sausage—Pork Added” or “Pork Sausage—with Turkey.” Food Labeling Division (FLD) Policy Memorandum 005A.

Each of these examples and numerous others found in FDA and USDA regulations should stand as precedent for an amount greater than 10 percent being adopted by TTB as the upper limit on alcohol contributed other than by fermentation. Combined with the FDA precedents, a 51/49 or majority standard seems eminently reasonable.

In an era when individuals and businesses are overly taxed and regulated, please do not add to that burden. Thank you for your consideration.

Sincerely,

Thomas Schatz	John Berthoud
President	President
Citizens Against Government Waste	National Taxpayers Union

Steve Ellis
Vice President of Programs
Taxpayers for Common Sense